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SENSITIVE BUT UNCLASSIFIED

SIPDIS

E.O. 12958:N/A

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SUBJECT: LATVIA: 2010 BUDGET DEMARCHE RECOMMENDATION: DEPARTMENT
GUIDANCE REQUESTED

REF: A. Meyer-Garber 10/8/09 e-mail; B. RIGA 494, C. RIGA 484 D.
STOCKHOLM 632, E. RIGA 238, F. RIGA 191

¶1. (U) This is an action request.

¶2. (SBU) Post seeks Department concurrence on a draft demarche to be delivered to appropriate GOL officials (including the Prime Minister) regarding Latvia's 2010 budget. The demarche will urge the government of Latvia to abide by its signed commitments to the International Monetary Fund and the European Commission and pass a credible 2010 budget that reduces the fiscal deficit by 4 percent of GDP or LVL 500 million (USD 1 billion).

¶3. (SBU) The following are our recommended points for the demarche:

-- The U.S. will continue to support Latvia during these very difficult economic times and we pledge to work with Latvia as it seeks to return to sustainable economic growth.

-- We understand that Latvia is facing some very difficult choices and legitimate concerns about the impact of additional expenditure cuts and/or tax increases envisioned in the 2010 budget.

-- We welcome the significant progress made so far.

-- Nonetheless, we strongly urge the government of Latvia to abide by its commitments to the International Monetary Fund and the European Commission and pass a 2010 budget that reduces the fiscal deficit by 4 percent of GDP or 500 million LVL.

-- If Latvia does not honor its commitments it will be difficult to support further disbursements. The credibility of Latvia's program and its exit to successful euro adoption is at stake.

-- Failure to abide by these commitments would undermine confidence in the government of Latvia to implement the program consistent with its stated goals and could lead to unintended consequences, including further downgrading of Latvian debt, immediate calls on its loans and even a possible run on Latvia's currency.

-- The agreement reached with your government clearly states that the 500 million LVL in budget adjustment for 2010 should not be achieved only through expenditure cuts. This would be too hard on society, particularly for low-income families. We consider it important to safeguard social safety nets as agreed with the IMF and EC, to ensure a fair distribution of the adjustment on the population.

-- Although Latvia's adjustments have been painful, there appears to be some renewed, but cautious interest in Latvia from investors.

-- Changing course now could undermine this progress.

-- As Latvia implements fair and equitable policies to ensure long-term fiscal stability and eventual euro adoption, the U.S. will continue to search for opportunities to strengthen our bilateral economic relationship through trade and investment opportunities.

-- Finally, we would like to reiterate our previous offers of technical assistance in support of these difficult budget decisions.

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